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section 501(h) before it is determined to be an eligible organization and may submit Form 5768 at the time it submits its application for recognition of exemption (Form 1023). If the newly created organization is determined to be an eligible organization, the election will be effective under the provisions of paragraph (a) of this section, that is, with the beginning of the taxable year in which the Form 5768 is filed by the eligible organization. However, if a newly created organization is determined by the Service not to be an eligible organization, the organization's election will not be effective and the substantial part test will apply from the effective date of its section 501(c)(3) classification.

(d) *Voluntary revocation of expenditure test election*—(1) *Revocation effective*. An organization may voluntarily revoke an expenditure test election by filing a notice of voluntary revocation with the appropriate Internal Revenue Service Center listed on Form 5768. Under section 501(h)(6)(B), a voluntary revocation is effective with the beginning of the first taxable year after the taxable year in which the notice is filed. If an organization voluntarily revokes its election, the substantial part test of section 501(c)(3) will apply with respect to the organization's activities in attempting to influence legislation beginning with the taxable year for which the voluntary revocation is effective.

(2) *Re-election of expenditure test*. If an organization's expenditure test election is voluntarily revoked, the organization may again make the expenditure test election, effective no earlier than for the taxable year following the first taxable year for which the revocation is effective.

(3) *Example*. X, an organization whose taxable year is the calendar year, plans to voluntarily revoke its expenditure test election effective beginning with its taxable year 1985. X must file its notice of voluntary revocation on Form 5768 after December 31, 1983, and before January 1, 1985. If X files a notice of voluntary revocation on December 31, 1984, the revocation is effective beginning with its taxable year 1985. The organization may again elect the expenditure test by filing Form 5768. Under

paragraph (d)(2) of this section, the election may not be made for taxable year 1985. Under paragraph (a) of this section, a new expenditure test election will be effective for taxable years beginning with taxable year 1986, if the Form 5768 is filed after December 31, 1985, and before January 1, 1987.

(e) *Involuntary revocation of expenditure test election*. If, while an election by an eligible organization is in effect, the organization ceases to be an eligible organization, its election is automatically revoked. The revocation is effective with the beginning of the first full taxable year for which it is determined that the organization is not an eligible organization. If an organization's expenditure test election is involuntarily revoked under this paragraph (e) but the organization continues to be described in section 501(c)(3), the substantial part test of section 501(c)(3) will apply with respect to the organization's activities in attempting to influence legislation beginning with the first taxable year for which the involuntary revocation is effective.

(f) *Supersession*. This section supersedes § 7.0(c)(4) of the Temporary Income Tax Regulations under the Tax Reform Act of 1976, effective August 31, 1990.

[T.D. 8308, 55 FR 35588, Aug. 31, 1990]

§ 1.501(h)-3 Lobbying or grass roots expenditures normally in excess of ceiling amount.

(a) *Scope*. This section provides rules under section 501(h) for determining whether an organization that has elected the expenditure test and that is not a member of an affiliated group of organizations (as defined in § 56.4911-7(e)) either normally makes lobbying expenditures in excess of its lobbying ceiling amount or normally makes grass roots expenditures in excess of its grass roots ceiling amount. Under section 501(h) and this section, an organization that has elected the expenditure test and that normally makes expenditures in excess of the corresponding ceiling amount will cease to be exempt from tax under section 501(a) as an organization described in section 501(c)(3). For similar rules relating to

members of an affiliated group of organizations, see § 56.4911-9.

(b) *Loss of exemption*—(1) *In general.* Under section 501(h)(1), an organization that has elected the expenditure test shall be denied exemption from taxation under section 501(a) as an organization described in section 501(c)(3) for the taxable year following a determination year if—

(i) The sum of the organization's lobbying expenditures for the base years exceeds 150 percent of the sum of its lobbying nontaxable amounts for the base years, or (ii) The sum of the organization's grass roots expenditures for its base years exceeds 150 percent of the sum of its grass roots nontaxable amounts for the base years.

The organization thereafter shall not be exempt from tax under section 501(a) as an organization described in section 501(c)(3) unless, pursuant to paragraph (d) of this section, the organization re-applies for recognition of exemption and is recognized as exempt.

(2) *Special exception for organization's first election.* For the first, second, or third consecutive determination year for which an organization's first expenditure test election is in effect, no determination is required under paragraph (b)(1) of this section, and the organization will not be denied exemption from tax by reason of section 501(h) and this section if, taking into account as base years only those years for which the expenditure test election is in effect—

(i) The sum of the organization's lobbying expenditures for such base years does not exceed 150 percent of the sum of its lobbying nontaxable amounts for the same base years, and

(ii) The sum of the organization's grass roots expenditure for those base years does not exceed 150 percent of the sum of its grass roots nontaxable amounts for such base years. If an organization does not satisfy the requirements of this paragraph (b)(2), paragraph (b)(1) of this section will apply.

(c) *Definitions.* For purposes of this section—

(1) The term *lobbying expenditures* means lobbying expenditures as defined in section 4911(c)(1) or section 4911(f)(4)(A) and § 56.4911-2(a).

(2) The term *lobbying nontaxable amount* is defined in § 56.4911-1(c)(1).

(3) An organization's *lobbying ceiling amount* is 150 percent of the organization's lobbying nontaxable amount for a taxable year.

(4) The term *grass roots expenditures* means expenditures for grass roots lobbying communications as defined in section 4911(c)(3) or section 4911(f)(4)(A) and §§ 56.4911-2 and 56.4911-3.

(5) The term *grass roots nontaxable amount* is defined in § 56.4911-1(c)(2).

(6) An organization's *grass roots ceiling amount* is 150 percent of the organization's grass roots nontaxable amount for a taxable year.

(7) In general, the term *base years* means the determination year and the three taxable years immediately preceding the determination year. The base years, however, do not include any taxable year preceding the taxable year for which the organization is first treated as described in section 501(c)(3).

(8) A taxable year is a *determination year* if it is a year for which the expenditure test election is in effect, other than the taxable year for which the organization is first treated as described in section 501(c)(3).

(d) *Reapplication for recognition of exemption*—(1) *Time of application.* An organization that is denied exemption from taxation under section 501(a) by reason of section 501(h) and this section may apply on Form 1023 for recognition of exemption as an organization described in section 501(c)(3) for any taxable year following the first taxable year for which exemption is so denied. See paragraphs (d)(2) and (d)(3) of this section for material to be included with an application described in the preceding sentence.

(2) *Section 501(h) calculation.* An application described in paragraph (d)(1) of this section must demonstrate that the organization would not be denied exemption from taxation under section 501(a) by reason of section 501(h) if the expenditure test election has been in effect for all of its last taxable year ending before the application is made by providing the calculations, described either in paragraphs (b)(1) (i) and (ii) of this section or in § 56.4911-9(b), that would have applied to the organization for that year.

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(3) *Operations not disqualifying.* An application described in paragraph (d)(1) of this section must include information that demonstrates to the satisfaction of the Commissioner that the organization will not knowingly operate in a manner that would disqualify the organization for tax exemption under section 501(c)(3) by reason of attempting to influence legislation.

(4) *Reelection of expenditure test.* If an organization is denied exemption from tax for a taxable year by reason of section 501(h) and this section, and there-

after is again recognized as an organization described in section 501(c)(3) pursuant to this paragraph (d), it may again elect the expenditure test under section 501(h) in accordance with § 1.501(h)-2(a).

(e) *Examples.* The provisions of this section are illustrated by the following examples, which also illustrate the operation of the tax imposed by section 4911.

Example 1. (1) The following table contains information used in this example concerning organization X.

Year	Exempt purpose expenditures (EPE)	Calculation	Lobbying	
			Nontaxable amount (LNTA)	Lobbying expenditures (LE)
1979	\$400,000	(20% of \$400,000=)	\$80,000	\$100,000
1980	300,000	(20% of \$300,000=)	60,000	100,000
1981	600,000	(20% of \$500,000+15% of \$100,000=)	115,000	120,000
1982	500,000	(20% of \$500,000=)	100,000	100,000
Totals	1,800,000	.....	355,000	420,000

(2) Organization X, whose taxable year is the calendar year, was organized in 1971. X first made the expenditure test election under section 501(h) effective for taxable years beginning with 1979 and has not revoked the election. None of X's lobbying expenditures for its taxable years 1979 through 1982 are grass roots expenditures. Under section 4911(a) and § 56.4911-1(a), X must determine for each year for which the expenditure test election is effective whether it is liable for the 25 percent excise tax imposed by section 4911(a) on excess lobbying expenditures. X is liable for this tax for each of its taxable years 1979, 1980, and 1981, because in each year its lobbying expenditures exceeded its lobbying nontaxable amount for the year. For 1979, the tax imposed by section 4911(a) is \$5,000 $\{25\% \times (\$100,000 - \$80,000) = \$5,000\}$. For 1980, the tax is \$10,000. For 1981, the tax is \$1,250.

(3) The taxable years 1979 through 1981 are all determination years under paragraph (c)(8) of this section. On its annual return for determination year 1979, the first year of its first election, X can demonstrate, under paragraph (b)(2) of this section, that its lobbying expenditures during 1979 (\$100,000) do not exceed 150 percent of its lobbying nontaxable amount for 1979 (\$120,000). For determination year 1980, under paragraph (b)(2), X can demonstrate that the sum of its lobbying

expenditures for 1979 and 1980 (\$200,000) does not exceed 150 percent of the sum of its lobbying nontaxable amounts for 1979 and 1980 (\$210,000). For 1981, under paragraph (b)(2), X can demonstrate that the sum of its lobbying expenditures for 1979, 1980, and 1981 (\$320,000) does not exceed 150 percent of the sum of its lobbying nontaxable amounts for 1979, 1980, and 1981 (\$382,500). For each of the determination years 1979, 1980, and 1981, the first three years of its first election, X satisfies the requirements of paragraph (b)(2). Accordingly, no determination under paragraph (b)(1) of this section is required for those years, and X is not denied tax exemption by reason of section 501(h).

(4) Under paragraph (b)(1) of this section, X must determine for its determination year 1982 whether it has normally made lobbying expenditures in excess of the lobbying ceiling amount. This determination takes into account expenditures in base years 1979 through 1982. The sum of X's lobbying expenditures for the base years (\$420,000) does not exceed 150 percent of the sum of the lobbying nontaxable amounts for the base years $(150\% \times \$355,000 = \$532,500)$. Accordingly, X is not denied tax exemption by reason of section 501(h).

Example 2. (1) The following table contains information used in this example concerning W.

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Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE) (dollars)	Grass roots nontaxable amount (25 percent of LNTA) (dollars)	Grass roots expenditures (dollars)
1979	700,000	(20% of \$500,000+15% of \$200,000=).	130,000	120,000	32,500	30,000
1980	800,000	(20% of \$500,000+15% of \$300,000=).	145,000	100,000	36,250	60,000
1981	800,000	(20% of \$500,000+15% of \$300,000=).	145,000	100,000	36,250	65,000
1982	900,000	(20% of \$500,000+15% of \$400,000=).	160,000	150,000	40,000	65,000
Total	3,200,000	.....	580,000	470,000	145,000	220,000

(2) Organization W, whose taxable year is the calendar year, made the expenditure test election under section 501(h) effective for taxable years beginning with 1979 and has not revoked the election. W has been treated as an organization described in section 501(c)(3) for each of its taxable years beginning within its taxable year 1974.

(3) Under section 4911(a) and § 56.4911-1(a), W must determine for each year for which the expenditure test election is effective whether it is liable for the 25 percent excise tax imposed by section 4911(a) on excess lobbying expenditures. In 1980, 1981, and 1982, W has excess lobbying expenditures because its grass roots expenditures in each of those years exceeded its grass roots nontaxable amount for the year. Therefore, W is liable for the excise tax under section 4911(a) for those years. The tax imposed by section 4911(a) for 1980 is \$5,937.50 {25%×(\$60,000−\$36,250)= \$5,937.50}. For 1981, the tax is \$7,187.50. For 1982, the tax is \$6,250.

(4) On its annual return for its determination years 1979, 1980, and 1981, the first three years of its first election, W demonstrates that it satisfies the requirements of paragraph (b)(2) of this section. Accordingly, no determination under paragraph (b)(1) of this section is required for those years, and W is

not denied tax exemption by reason of section 501(h).

(5) On its annual return for its determination year 1982, W must determine under paragraph (b)(1) whether it has normally made lobbying expenditures or grass roots expenditures in excess of the corresponding ceiling amount. This determination takes into account expenditures in base years 1979 through 1982. The sum of W's lobbying expenditures for the base years (\$470,000) does not exceed 150% of the sum of W's lobbying nontaxable amounts for those years (150%×\$580,000=\$870,000). However, the sum of W's grass roots expenditures for the base years (\$220,000) does exceed 150% of the sum of W's grass roots nontaxable amounts for those years (150%×\$145,000=\$217,500). Under section 501(h), W is denied tax exemption under section 501(a) as an organization described in section 501(c)(3) for its taxable year 1983. For its taxable year 1984 and any taxable year thereafter, W is exempt from tax as an organization described in section 501(c)(3) only if W applies for recognition of its exempt status under paragraph (d) of this section and is recognized as exempt from tax.

Example 3. (1) The following table contains information used in this example concerning organization Y.

Taxable Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE)(dollars)	Grass roots nontaxable amount (25 percent of LNTA)(dollars)	Grass roots expenditures (dollars)
1977	700,000	(20% of \$500,000+15% of \$200,000=).	130,000	182,000	32,500	30,000
1978	800,000	(20% of \$500,000+15% of \$300,000=).	145,000	224,750	36,250	35,000
Subtotal	1,500,000	.....	275,000	406,750	68,750	65,000

Taxable Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE)(dollars)	Grass roots nontaxable amount (25 percent of LNTA)(dollars)	Grass roots expenditures (dollars)
1979	900,000	(20% of \$500,000+15% of \$400,000=).	160,000	264,000	40,000	50,000
Totals:	2,400,000	.....	435,000	670,750	108,750	115,000

(2) Organization Y, whose taxable year is the calendar year, was first treated as an organization described in section 501(c)(3) on February 1, 1977. Y made the expenditure test election under section 501(h) effective for taxable years beginning with 1977 and has not revoked the election.

(3) For 1977, Y has excess lobbying expenditures of \$52,000 because its lobbying expenditures (\$182,000) exceed its lobbying nontaxable amount (\$130,000) for the taxable year. Accordingly, Y is liable for the 25 percent excise tax imposed by section 4911(a). The amount of the tax is \$13,000 [$25\% \times (\$182,000 - \$130,000) = \$13,000$].

(4) For 1978, Y again has excess lobbying expenditures and is again liable for the 25 percent excise tax imposed by section 4911(a). The amount of the tax is \$19,937.50 [$25\% \times (\$224,750 - \$145,000) = \$19,937.50$].

(5) For 1979, Y's lobbying expenditures (\$264,000) exceed its lobbying nontaxable amount (\$160,000) by \$104,000, and its grass roots expenditures (\$50,000) exceed its grass roots nontaxable amount (\$40,000) by \$10,000. Under § 56.4911-1(b), Y's excess lobbying expenditures are the greater of \$104,000 or \$10,000. The amount of the tax, therefore, is \$26,000 [$25\% \times \$104,000 = \$26,000$].

(6) Under paragraph (c)(8) of this section, 1977 is not a determination year because it is the first year for which the organization is treated as described in section 501(c)(3). For 1977, Y need not determine whether it has normally made lobbying expenditures or grass roots expenditures in excess of the corresponding ceiling amount for purposes of determining whether it is denied exemption under section 501(h) for its taxable year 1978.

(7) For determination year 1978, Y must determine whether it has normally made lobbying or grass roots expenditures in excess of the corresponding ceiling amount, taking into account expenditures for the base years 1977 and 1978. For Y, the determination under paragraph (b)(2) of this section considers the same base years as the determination under paragraph (b)(1) of this section and is, therefore, redundant. Accordingly, Y proceeds to determine, under (b)(1), whether it is denied exemption. Y's grass roots expenditures for 1977 and 1978 (\$65,000) did not exceed 150 percent of the sum of its grass roots nontaxable amounts for those years (\$103,125). Y's lobbying expenditures for 1977 and 1978 (\$406,750)

did not exceed 150% of its lobbying nontaxable amount for those years ($150\% \times \$275,000 = \$412,500$). Therefore, Y is not denied tax exemption under section 501(h) for its taxable year 1979.

(8) For determination year 1979, the sum of Y's grass roots expenditures in base years 1977, 1978, and 1979 does not exceed 150 percent of its grass roots nontaxable amount (calculation omitted). However, the sum of Y's lobbying expenditures for the base years (\$670,750) does exceed 150% of the sum of the lobbying nontaxable amounts for those years ($150\% \times \$435,000 = \$652,500$). Since Y was not described in section 501(c)(3) prior to 1977, only the years 1977, 1978, and 1979 may be considered in determining whether Y has normally made lobbying expenditures in excess of its lobbying ceiling. Therefore, Y determines that it has normally made lobbying expenditures in excess of its lobbying ceiling. Under section 501(h), Y is denied tax exemption under section 501(a) as an organization described in section 501(c)(3) for its taxable year 1980. For its taxable year 1981, and any taxable year thereafter, Y is exempt from tax as an organization described in section 501(c)(3) only if Y applies for recognition of its exempt status under paragraph (d) of this section and is recognized as exempt from tax.

Example 4. Organization M made the expenditure test election under section 501(h) effective for taxable years beginning with 1977 and has not revoked the election. M has \$500,000 of exempt purpose expenditures during each of the years 1981 through 1984. In addition, during each of those years, M spends \$75,000 for direct lobbying and \$25,000 for grass roots lobbying. Since the amount expended for M's lobbying (both total lobbying and grass roots lobbying) is within the respective nontaxable expenditure limitations, M is not liable for the 25 percent excise tax imposed under section 4911(a) upon excess lobbying expenditures, nor is M denied tax-exempt status by reason of section 501 (h).

Example 5. Assume the same facts as in Example 4, except that, on behalf of M, numerous unpaid volunteers conduct substantial lobbying activities with no reimbursement. Since the substantial lobbying activities of the unpaid volunteers are not counted towards the expenditure limitations and the amount expended for M's lobbying is within

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the respective nontaxable expenditure limitations, M is not liable for the 25 percent excise tax under section 4911, nor is M denied tax-exempt status by reason of section 501(h).

[T.D. 8308, 55 FR 35589, Aug. 31, 1990]

§ 1.501(k)-1 Communist-controlled organizations.

Under section 11(b) of the Internal Security Act of 1950 (50 U.S.C. 790(b)), as amended, which is made applicable to the Code by section 7852(b) of that Code, no organization is entitled to exemption under sections 501(a) or 521(a) for any taxable year if at any time during such year such organization is registered under section 7 of such Act or if there is in effect a final order of the Subversive Activities Control Board established by section 12 of such Act requiring such organization to register under section 7 of such Act, or determining that it is a Communist-infiltrated organization.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960; redesignated by T.D. 8100, 51 FR 31615, Sept. 4, 1986]

§ 1.502-1 Feeder organizations.

(a) In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt edu-

cational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of:

- (1) A parent organization and one or more of its subsidiary organizations; or
- (2) Subsidiary organizations having a common parent organization

An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities.

(c) In certain cases an organization which carries on a trade or business for profit but is not operated for the primary purpose of carrying on such trade or business is subject to the tax imposed under section 511 on its unrelated business taxable income.

(d) *Exception*—(1) *Taxable years beginning before January 1, 1970.* For purposes of section 502 and this section, for taxable years beginning before January 1, 1970, the term *trade or business* does not include the rental by an organization of its real property (including personal property leased with the real property).

(2) *Taxable years beginning after December 31, 1969.* For purposes of section 502 and this section, for taxable years beginning after December 31, 1969, the term *trade or business* does not include:

- (i) The deriving of rents described in section 512(b)(3)(A),